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SUBJECT: ICELAND: GOVERNMENT FALLS, UNITY COALITION IN THE OFFING?

Refs: A) Reykjavik 012
B) Reykjavik 013
C) Reykjavik 015
D) Reykjavik 017

11. (U) Summary: Despite a weekend of frantic efforts by the leaders of Iceland's governing coalition to bring their parties to heel, Prime Minister Haarde announced January 26 that the governing coalition has fallen apart less than two years into its term. The immediate cause was the demand of the junior party, the Social Democratic Alliance, that the Haarde's Independence Party (IP) yield the Prime Minister's seat and make other concessions. While Haarde wants to establish a unity government with the IP at the head, there is considerable doubt that he will be successful. President Grimsson will meet with the heads of all the parties prior to giving one the mandate to form a coalition. Many expect the SDA to be tapped. Early parliamentary elections are expected. End Summary.

A Last-Ditch Effort Fails

12. (U) After Prime Minister Geir Haarde's dramatic announcement on January 23 that he has been diagnosed with cancer and that his Independence Party would call for early elections in May (ref D), the stage was set for a weekend of furious negotiation between the heads of the governing coalition. Haarde held several meetings over the course of the weekend with Social Democratic Alliance Chair and Foreign Minister Ingibjorg Solrun Gisladottir to discuss the future of the government. Adding to the drama, on January 25 Minister of Commerce Bjorgvin Sigurdsson (SDA) announced his resignation as well as that of the entire board of the Financial Supervisory Authority (FME). Sigurdsson said he hoped to take some responsibility for the banking collapse, while also pointedly suggesting that the Board of the Central Bank should consider doing the same.

13. (SBU) On January 26, the IP and SDA chairs met with their respective parliamentary caucuses to brief on the weekend's negotiations. The rumored outlines of the SDA's offer: in order to keep the coalition alive, the IP needed to fire Central Bank Chairman David Oddsson and the rest of the Board; agree to spring elections; and yield the Prime Ministry to an SDA designee. By most accounts, the third point was a bridge too far: the Political Advisor to the Minister of Finance (IP) told PolOff that his boss went into today's meeting willing to yield on the other requests, but that the IP would rather walk than surrender the Prime Minister's seat to its junior partner.

14. (U) Just after midday, PM Haarde announced to waiting press that

the Independence Party had been unable to agree to the SDA's demands, and that the coalition would dissolve. While thanking SDA Chair Gisladdottir for her warm and honorable collaboration over the last two years, Haarde had harsh words for the SDA and its "lack of courage" to press forward with the coalition. He added that the SDA demand for the Prime Ministry was a nonstarter and that it should have been obvious to the SDA that this would never be accepted. Referring to the urgent work awaiting the government as it implements the International Monetary Fund's recovery program (ref C), Haarde said he hoped to assemble a unity government under IP leadership.

15. (U) Haarde met with Icelandic President Olafur Ragnar Grimsson at day's end to formally relinquish his mandate to form a government. Grimsson will now meet with the heads of the country's other political parties, after which he will give one party the mandate to assemble a coalition. Many expect that he will choose Gisladdottir's SDA, given Grimsson's previous political career in one of the parties that combined to form the SDA.

What government next?

16. (SBU) Iceland will without a doubt see parliamentary elections in the coming months, two years ahead of schedule. The opposition parties, surging in polls as a result of popular displeasure with the government, will want to lock in their gains at the ballot box, and the outgoing government parties will want a chance to present a new face to the public. However, in the interim a caretaker government will most likely be established, and two possibilities are getting the most discussion: a unity government with all five parties in the Althingi, and a leftist minority government with the

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pledged support of the Progressive Party.

17. (SBU) On first reading, a unity government seems more likely, given that all parties have now stated their desire for one. However, such an agreement may be unattainable due to severe policy conflicts between the IP and the Left-Greens. The Left-Greens (and others) would be likely to object to a unity government under IP leadership, given the current discontent with the government. Beyond that, however, the Deputy Chair of the Left Green Movement told PolOff just before the government fell that the Greens would not come into government "just to be there. We have policy concerns that we want to see addressed," such as renegotiation or outright cancellation of the IMF loan and changes to the tax structure for corporations and individuals. IP stalwarts such as a leading investment banker have told EconOff that these moves are exactly what the IP -- and the broader business community -- fear. Such basic conflicts may make it impossible for the IP and the Left-Greens to be in the same government, even a caretaker unity government.

18. (SBU) A minority coalition between the Left-Greens and the SDA would also pose problems. Though the new Progressive Party (PP) chair has pledged to support such a minority coalition, the three parties disagree on a number of issues (such as EU membership). The SDA has also been a strong backer of the IMF bailout plan, which could hinder SDA-LG cooperation just as it would a unity government.

19. (SBU) COMMENT: Despite the unclear political situation and limited options for a new coalition, all parties agree that there is little room for delay. The Left-Greens want elections earlier than all other parties, but all want to vote sooner than later. We expect that a caretaker coalition, if there is to be one, will be announced in the next few days, and will carry with it a date for spring elections. Failing that, we expect President Grimsson to announce the Althingi's dissolution and elections to follow within 45 days, as specified by the constitution.

VAN VOORST